FILED
APR 28 1992
OFFICE OF THE CLERK

No. 91-1737

IN THE

Supreme Court of the United States

OCTOBER TERM, 1991

SHISEIDO COSMETICS (AMERICA) LTD.,

Petitioner,

—v.—

FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA,

Respondent.

ON PETITION FOR WRIT OF CERTIORARI
TO THE COURT OF APPEAL OF THE STATE OF CALIFORNIA,
THIRD APPELLATE DISTRICT

PETITION FOR WRIT OF CERTIORARI

Lloyd De Vos
(Counsel of Record)
Andrew W. Heymann
DE VOS & CO.
One World Financial Center
19th Floor
200 Liberty Street
New York, New York 10281
(212) 786-1000

Counsel for Petitioner
Shiseido Cosmetics (America) Ltd.

April, 1992

QUESTIONS PRESENTED

1. Was petitioner Shiseido Cosmetics (America) Ltd. (hereinafter "SCA"), denied a "plain" and "efficient" remedy, as required by the Due Process Clause of the Fourteenth Amendment to the United States Constitution, when its federal constitutional claims were dismissed from state court because of the absence of an administrative claim for refund to a state administrative agency that lacked jurisdiction to grant relief?

2. Is California's "notice of claim" filing requirement mandating the filing of an administrative claim for refund as a state court jurisdictional prerequisite to challenging the federal constitutional basis of a tax assessment permissible under *Felder v. Casey*, 487 U. S. 131 (1988).

3. Was SCA denied procedural due process of law in state court on its federal constitutional challenge to the tax assessed by the California Franchise Tax Board (hereinafter the "FTB"), a state administrative agency, when:

- the FTB was permitted to amend its answer three years after it was filed in the state court litigation;
- the FTB's amended answer retracted the admission contained in its answer that SCA had exhausted its administrative remedies;
- the amended answer was filed after the statute of limitations in which SCA could file an administrative claim for refund with the FTB had expired;
- there was no tolling or extension of the time limits for filing the allegedly required administrative claim for refund; and
- the result was a procedural dismissal of SCA's federal constitutional claims without a hearing on the merits?

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No. _____

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OPINIONS BELOW

The order of the Supreme Court of the State of California (Appendix A) is not reported. The opinion of the Court of Appeal of the State of California, Third Appellate District, (Appendix B) is reported at 235 Cal. App. 3d 478, 286 Cal. Rptr. 690 (1991). The denial of SCA's request for rehearing (Appendix C) is not reported.

The opinion and order of the Superior Court of the State of California in Case No. 3326238 (Appendix D) and the opinion and order of the Superior Court of the State of California in Case No. 512689 (Appendix F) are not reported.

The decision of the California State Board of Equalization (Appendix G) and the decision of the California Franchise Tax Board (Appendix H) are not reported.

JURISDICTION

The jurisdiction of the Supreme Court of the United States to review the order and judgment of the Supreme Court of the State of California is invoked under 28 U.S.C. § 1257(a).

The Supreme Court of the State of California entered its opinion on February 20, 1992 declining to review the opinion and judgment of the Court of Appeal of the State of California, Third Appellate District (Appendix A). The opinion and judgment of the Court of Appeal of the State of California, Third Appellate District, was entered on October 21, 1991 (Appendix B) and the order denying rehearing was entered on November 14, 1991 (Appendix C).

CONSTITUTIONAL, STATUTORY AND REGULATORY PROVISIONS

Due Process Clause (Amend. V):

> No person shall be . . . deprived of life, liberty, or property, without due process of law. . . .

Due Process Clause (Amend XIV, § 1):

> [N]or shall any State deprive any person of life, liberty, or property, without due process of law. . . .

California Constitution, Article III, Section 3.5:

> An administrative agency, including an administrative agency created by the Constitution or an initiative statute, has no power:
>
> (a) To declare a statute unenforceable, or refuse to enforce a statute, on the basis of its being unconstitutional unless an appellate court has made a determination that such statute is unconstitutional;

(b) To declare a statute unconstitutional;

(c) To declare a statute unenforceable, or to refuse to enforce a statute on the basis that federal law or federal regulations prohibit the enforcement of such statute unless an appellate court has made a determination that the enforcement of such statute is prohibited by federal law or federal regulations.

California Constitution, article XIII, section 32:

No legal or equitable process shall issue in any proceeding in any court against this State or any officer thereof to prevent or enjoin the collection of any tax. After payment of a tax claimed to be illegal, an action may be maintained to recover the tax paid, with interest, in such manner as may be provided by the Legislature.

California Revenue and Taxation Code, Section 26102:

Except as provided in Section 26103a, after payment of the tax and denial by the Franchise Tax Board of a claim for refund, any taxpayer claiming that the tax computed and assessed against it under this part is void in whole or in part may bring an action, upon the grounds set forth in its claim for refund, against the Franchise Tax Board for the recovery of the whole or any part of the amount paid.

California Revenue and Taxation Code, Section 26103:

The action provided by Section 26102 shall be filed within four years from the last date prescribed for filing the return or within one year from the date the tax was paid, or within 90 days after (a) notice of action by the Franchise Tax Board upon any claim for refund, or (b) notice of action by the State Board of Equalization on an appeal from the action of the Franchise Tax Board on a claim for refund, whichever period expires the later.

California Revenue and Taxation Code, Section 26103:

> Failure to begin an action within the time specified in this article shall be a bar against the recovery of taxes.

California Revenue and Taxation Code, Section 26073:

> No credit or refund shall be allowed or made after four years from the last day prescribed for filing the return or after one year from the date of the overpayment, whichever period expires the later, unless before the expiration of the period a claim therefor is filed by the taxpayer, or unless before the expiration of the period the Franchise Tax Board allowed a credit, made a refund, mailed a notice of proposed overpayment on a preprinted form prescribed by the Franchise Tax Board, or certified the overpayment to the State Board of Control for approval of the refunding thereof.

California Revenue and Taxation Code, Section 26074:

> Every claim for refund shall be in writing and state the specific grounds upon which it is founded.

STATEMENT OF THE CASE

In December, 1978, SCA timely protested notices of proposed assessments by the FTB for the tax years 1971 to 1975.[1] The FTB calculated SCA's additional tax liability based upon application of worldwide combined reporting for a unitary business (the "unitary tax method") with a foreign parent company, which included the business of Shiseido Co., Ltd. and its affiliates and subsidiaries throughout the world. (App. B, at 2b). SCA protested the tax assessment claiming the application of California's unitary tax method to a foreign based corporate group violated the United States

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1 All of the parties to the proceedings below are referenced in the caption to this petition.

Petitioner, SCA, is the wholly owned subsidiary corporation of Shiseido International Corp., which in turn is substantially wholly owned by Shiseido Co., Ltd., a Japanese corporation.

Constitution. (App. B, at 2b). On October 24, 1979, FTB acknowledged the constitutional arguments raised by SCA (App. H, at 6h; App. B, 2b), but subsequently denied the protest.

In February, 1980, SCA timely petitioned the California State Board of Equalization (hereinafter the "SBE") for redetermination of the FTB's denial of the protests. The SBE placed SCA's tax appeal on indefinite deferred status. (App. B, 4b). The SBE agreed that the SCA constitutional challenge to California's unitary tax method was "beyond the decision-making authority of our Board." (App. B, at 4b).

In April, 1985, SCA again informed the SBE that the sole basis for its challenge to the tax was on constitutional grounds:

> The only issue remaining is the issue of whether the State of California has the legal right under the applicable provisions to the United States Constitution to impose the unitary basis of taxation on corporations incorporated in one of the United States, which have a non-United States parent company by bringing into the tax base the financial status and results of that non-United States parent company.

(App. B, 5b). The FTB was a party to proceedings before the SBE. Both the SBE and the FTB were fully advised of the precise nature of SCA's constitutional challenge to the tax (App. B, at 6b).

After five years in "deferred" status, the SBE entered its decision sustaining the FTB's denial of the protest against the assessments and noted that SCA's protest raised constitutional issues only. The SBE held that the state agencies were precluded by Section 3.5 of Article III of the California Constitution from deciding the constitutionality of California's unitary method of taxation as applied to corporate groups with foreign parents. (App. B, 6b).

On November 18, 1985, SCA paid all taxes assessed plus interest "under protest". (App. B, at 6b).

In January, 1986, in reliance upon on the holding of the SBE that federal constitutional claims could not be reviewed by a state administrative agencies, SCA timely filed a complaint in California Superior Court, Case No. 326238, limiting the grounds for refund to its claim that the application of the unitary tax method to SCA violated the federal constitution and treaties of the United States. (App. B, 6-7b). SCA filed the complaint within the statute of limitations period for filing an administrative claim for refund.[2]

In March, 1986, the FTB answered the SCA complaint and *admitted* that SCA timely exhausted all administrative remedies prior to commencing the state court lawsuit. (App. B, 7b). At the time the FTB answered the SCA complaint, the statute of limitations for the filing of an administrative claim for refund was still open.

The parties "spent the next two years negotiating a set of stipulated facts to submit the case for judicial decision." (App. B, at 7b).

In June, 1989, more than *three* years after the FTB had admitted that SCA exhausted its administrative remedies, and only after the time for SCA to file a timely claim for refund had expired, the FTB filed a motion seeking leave to amend its answer to the complaint to retract its admission that SCA had exhausted its administrative remedies.[3] Over the objection of SCA, the trial court granted the motion. (App. B, at 7-8b; App. E).

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2 The limitation period for filing an administrative claim for refund under California Revenue and Taxation Code, § 26102 expired one year from the date of payment of the disputed tax by SCA, or November 18, 1986.

3 The FTB moved to amend its original answer to the complaint only after the trial court in *Barclays Bank Int'l Ltd. v. Franchise Tax Board*, Case Nos. 325059 and 325061 (Super. Ct. June 15, 1987) (Paras, J.), *aff'd* 232 Cal. App. 3d 1187 (Cal. Ct. App. 1990), *rev'w granted* (Cal. February 28, 1991), held California's unitary method of taxation as applied to foreign based unitary groups unconstitutional.

In its amended answer, the FTB claimed that SCA failed to exhaust its administrative remedies prior to commencing the state court action. (App. B, at 8b). The FTB then filed a motion for summary judgment claiming that SCA had failed to satisfy the "jurisdictional prerequisite" of exhausting its administrative remedies prior to commencing the state court action. In December, 1989, the trial court granted the FTB's motion for summary judgment in case no. 326238, (App. B, 8b; App. D).[4] No decision has been made on the merits of the federal constitutional claims raised by SCA in thirteen (13) years of proceedings in California.

SCA appealed the questions sought to be reviewed in this petition in its appeal to the Court of Appeal of the State of California, Third Appellate District, in its request for a rehearing to the Court of Appeal of the State of California, Third Appellate District and in its petition for review filed with the Supreme Court of the State of California.

REASONS FOR GRANTING THE PETITION

1. A FEDERAL CONSTITUTIONAL CHALLENGE TO THE ASSESSMENT OF A TAX NEED NOT BE BROUGHT BEFORE A STATE ADMINISTRATIVE AGENCY THAT LACKS JURISDICTION TO ADJUDICATE CONSTITUTIONAL ISSUES AS A "JURISDICTIONAL PREREQUISITE" TO OBTAINING A HEARING IN STATE COURT.

This case squarely presents to the Court for the first time the question of whether an individual taxpayer is required to adjudicate a federal constitutional challenge to a state tax in

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4 As soon as SCA learned that the FTB intended to file a motion to amend its answer to retract its admission that all administrative remedies had been exhausted, SCA filed an administrative claim for refund with the FTB and then commenced a second lawsuit, no. 512689, for refund. Case no. 512689 was dismissed because the administrative claim for refund was not timely made, i.e., was made later than one year after the tax was paid (App. B, at 8b; App. E, at 2e). Both state court cases, Nos. 326238 and 512689, were consolidated on appeal.

a state administrative agency that lacks jurisdiction to adjudicate constitutional issues, as a "jurisdictional prerequisite" to obtaining a hearing in state court.

The decisions of this Court finding a "plain, speedy and efficient" remedy in state tax cases have arisen to date in the context of Federal proceedings to obtain injunctive relief which has been found to be barred by the Tax Injunction Act, 28 U.S.C. § 1341.

In *Franchise Tax Bd. of Cal. v. Alcan Aluminum Ltd.*, 493 U.S. 331 (1990), this Court rejected a taxpayer's attempt to litigate its constitutional challenge to California's unitary tax method in federal court.[5] The Court held that "[t]o the extent they are available, California's refund procedures constitute a plain, speedy, and efficient remedy." 493 U.S. at 338 (citation omitted). The Court further noted that no case had been brought to its attention which indicated that the California courts refused to hear a claim challenging the subject tax. 493 U.S. at 339.

In *Tully v. Griffin*, 429 U.S. 72 (1976) (Tax Injunction Act barred injunction in federal district court against allegedly unconstitutional state tax), this Court affirmed that New York provided a taxpayer with a "plain, speedy and efficient" means to redress its constitutional claims because state law permitted the taxpayer to bring an action directly in state court to contest the constitutionality of the tax by declaratory judgment. 429 U.S. at 75.

In *Rosewell v. LaSalle National Bank*, 450 U.S. 503 (1981) (Tax Injunction Act barred federal district court injunction), this Court underscored that a state court must provide a taxpayer with procedural safeguards that amount to a "plain, speedy and efficient" remedy to challenge a state tax. 450 U.S. at 512. A proceeding which contains " 'uncertainty' surrounding a state-court remedy" does not satisfy procedural due process. 450 U.S. at 518. In *Rosewell*, the refund procedure was in effect a "reverse suit for refund" brought in a

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5 The substantive constitutional claims raised in *Alcan* are substantially the same as the substantive constitutional claims raised below.

state court that was empowered to adjudicate constitutional issues, had they been presented. 450 U.S. at 510 and n.7.

In *Rosewell*, this Court also addressed the "efficient" element of the "plain, speedy and efficient" remedy requirement:

> Because the Illinois remedy imposes no unusual hardship on respondent requiring ineffectual activity or an unnecessary expenditure of time or energy, we cannot say that it is not efficient.

450 U.S. at 518.

The present case is not a case where the Tax Injunction Act applies because the petitioner attempted for thirteen (13) years to follow the path to constitutionally challenge the unitary tax method through the state system. The present case is also not a case where the petitioner is seeking to avoid payment of state tax by means of injunction, since the tax at issue has been paid.

It is not in dispute that the California state administrative agencies had no jurisdiction to review, consider or provide any remedy with respect to a constitutional challenge to a state tax. Cal. Constitution, Article III, Section 3.5. Under the ruling below, the taxpayer was nonetheless required to protest the tax to the FTB, raising its constitutional claims, appeal the decision of the FTB to the SBE, again raising its constitutional claims, and then re-submit its claim for refund for adjudication to the FTB,[6] as a "jurisdictional prerequisite" to raising its federal constitutional claims in state court, even when the sole grounds for refund are that the state tax violates the United States Constitution and treaty obligations of the United States. Unlike the state tax schemes in New

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6 In *Rosewell*, *supra*, this Court noted that a remedy requiring repetitive suits on the same issue may not satisfy the "efficient" element of the due process analysis. 450 U.S. at 518 and n.22.

York and Illinois, at issue in *Tully* and *Rosewell*, *supra*,[7] under the holding below, California provides no method to challenge the constitutionality of the state tax without first applying to a state administrative agency that is powerless to grant any remedy. Failure to do so resulted in the substantive federal constitutional and treaty claims being dismissed on procedural grounds for failure to exhaust administrative remedies that could provide no relief.

Due process of law in state tax cases requires that access to the forum that has exclusive jurisdiction over the federal constitutional issues raised be as expeditious, inexpensive and direct as possible. To require a taxpayer to adjudicate its constitutional challenge to a state tax, the sole ground for its claim of refund, before a state agency that lacks jurisdiction to adjudicate constitutional issues, and to make this requirement a "jurisdictional prerequisite" to obtaining a hearing in state court, unlawfully infringes the right of access to a court where a judicial proceeding offers the exclusive means of obtaining relief. *See Bodie v. Connecticut*, 401 U.S. 371, 376 (1971); *United States v. Kras*, 409 U.S. 434, 445 (1973).

Certiorari should be granted to ensure that a taxpayer who must pay a state tax which violates the Commerce and Due Process Clauses of the federal constitution and the treaties of the United States has a "plain," "speedy" and "efficient" remedy to challenge the state tax.

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7 The Fifth Circuit Court of Appeals in *McQueen v. Bullock*, 907 F.2d 1544 (5th Cir. 1990), noted that Texas similarly does not require a party to exhaust an administrative remedy that cannot realistically provide adequate relief to protect the asserted claim. 907 F.2d at 1548 and n.10.

2. A STATE IS NOT PERMITTED, UNDER *FELDER v. CASEY*, 487 U.S. 131 (1988), TO MANDATE EXHAUSTION OF A STATE ADMINISTRATIVE REMEDY AS A "JURISDICTIONAL PREREQUISITE" TO FILING A FEDERAL CONSTITUTIONAL CLAIM IN STATE COURT.

Alcan, *supra*, teaches that Federal constitutional challenges to a state tax should be brought in the state court system unless no plain, speedy and efficient remedy exists. *Felder v. Casey*, 487 U.S. 131 (1988) holds that persons aggrieved because they have been deprived of federal constitutional rights have immediate access to the state courts:

> Given the evil at which the federal civil rights legislation was aimed, there is simply no reason to suppose that Congress . . . contemplated that those who sought to vindicate their rights in state courts could be required to seek redress in the first instance from the very state officials whose hostility to those rights precipitated their injuries. *Id.* at 147.

This Court has repeatedly held that where the only claim raised is a constitutional claim over which the administrative agency has no power to adjudicate and as to which the administrative agency cannot grant relief, administrative remedies have been exhausted. *See Mathews v. Diaz*, 426 U.S. 67, 76-77 (1975); *Weinberger v. Salfi*, 422 U.S. 749, 765 (1974); *Gibson v. Berryhill*, 411 U.S. 564, 574 (1972); *McNeese v. Bd. of Education*, 373 U.S. 668, 674-75 (1962); *Mont. Bank v. Yellowstone County*, 276 U.S. 499, 505 (1927). There is no question in the present case that the state administrative agency had no power to adjudicate and could not grant relief. Cal. Constitution, Article III, Sec. 3.5.

The substantive claims raised by SCA below are limited to federal constitutional claims and claims arising under the treaty obligations of the United States. In contradiction to *Felder*, the court below held that the failure by SCA to pursue its claim before the same administrative agency that had

denied its protest and had been its adversary before the SBE precluded consideration of its federal claims in state court.

Certiorari should be granted to resolve the conflict between the decision of the court below as to how federal constitutional rights can be vindicated and the decision of this court in *Felder*.

3. THE PROCEDURE EMPLOYED IN THE CALIFORNIA COURTS BELOW WHICH PERMITTED THE FTB TO AMEND ITS ANSWER AND RETRACT ITS ADMISSION THAT SCA HAD EXHAUSTED ADMINISTRATIVE REMEDIES, ONLY AFTER THE STATUTE OF LIMITATIONS DURING WHICH SCA COULD SEEK ADMINISTRATIVE REMEDIES HAD RUN, VIOLATES THE REQUIREMENTS OF FUNDAMENTAL FAIRNESS AND FAIR PLAY BETWEEN A STATE AND ITS CITIZENS.

Due process requires that the state provide a fundamentally fair procedure to permit federal constitutional challenges to the taking of property in the form of taxes.

The imposition of a state tax is a "deprivation of property." *McKesson Corp. v. Div. of Alcoholic Beverages & Tobacco*, 496 U.S. 18, 110 S.Ct. 2238, 2250 (1990). Prior to finally depriving a citizen of property, "to satisfy the requirements of the Due Process Clause, . . . the State must provide taxpayers with . . . a fair opportunity to challenge the accuracy and legal validity of their tax obligation . . . ." 496 U.S. at ____, 110 S.Ct. at 2251.

In *Mathews v. Eldridge*, 424 U.S. 319 (1975), the Court reviewed the requirements of procedural due process:

> This Court consistently has held that some form of hearing is required before an individual is finally deprived of a property interest. (Citations omitted). The "right to be heard before being condemned to suffer grievous loss of any kind, even though it may not involve the stigma and hardships of a criminal conviction, is a principle basic to

> our society. (Citation omitted). The fundamental requirement of due process is the opportunity to be heard "at a meaningful time and in a meaningful manner." (Citation omitted).

424 U.S. at 333.

It is difficult to contemplate a legal result which is less fair than that which took place below. It was not until the eleventh year of this litigation that the issue of exhaustion of administrative remedies arose, and then only after the statute of limitations for SCA to file a third administrative claim had expired. The constitutional challenge languished for eight (8) years in administrative agencies that did not have the power to provide relief. It languished a further three (3) years in the state trial courts. During this entire eleven (11) year period, all parties had no doubt as to the nature of the constitutional claims raised.

Fundamental fairness requires an even playing field upon which the state is held to a standard at least as stringent as that of the citizen. The court below freely excused what it perceived to be a mistake on the part of the state in holding that an "Amendment to correct a mistake [on the part of FTB in admitting exhaustion of administrative remedies] is allowed" (App. B, 25b). The court below then held that any prejudice to SCA from that holding "stems primarily from [SCA's] own failure to investigate the facts before filing its own verified complaint, which alleged it has exhausted administrative remedies" (App. B, 25b). The holding of the court below ignored any fault on the part of the state in admitting that all administrative remedies had been exhausted, even though its holding foreclosed the right of the citizen to have its claim heard on the merits.

Had the FTB properly and timely denied that SCA exhausted its administrative remedies, SCA would not have been time-barred from taking remedial steps to rectify any alleged procedural omissions. Instead, in its original answer to the complaint, the FTB admitted that SCA had exhausted all administrative remedies. The FTB waited *three* years

before claiming that as a result of administrative inadvertence or mistake it needed to amend its answer to the complaint to retract its admission that SCA exhausted its administrative remedies and claim that the time period had run for SCA to file a claim for refund.

Had the trial court permitted the FTB to amend its answer, but tolled the time period for filing a valid claim for refund to allow SCA to file a new claim for refund, SCA would not now be procedurally foreclosed from having a hearing on the merits of its constitutional claims. Instead, the trial court permitted the FTB to amend its answer on the basis of "inadvertence and mistake" without any concomitant relief for SCA.

As a result of this series of actions, each tilting the playing field further in one direction, SCA was foreclosed from having its constitutional challenge to California's unitary tax method heard in California state court, as contemplated by this Court in *Alcan*, *supra*.

Certiorari should be granted to allow SCA its fundamental and important Federal right to a hearing on the merits of its constitutional claim.

CONCLUSION

For the foregoing reasons, Petitioner, Shiseido Cosmetics (America) Ltd., respectfully requests that this Court grant its Petition for Writ of Certiorari to review the decision of the Court of Appeal of the State of California, Third Appellate District, which foreclosed, without providing a hearing on the merits, SCA's thirteen (13) year federal constitutional challenge to California's application of the unitary method of worldwide combined reporting to a foreign based corporate group.

Dated: April 23, 1992 Respectfully submitted,

/s/ LLOYD DE VOS

Lloyd De Vos
(Counsel of Record)
Andrew W. Heymann
DE VOS & CO.
One World Financial Center
19th Floor
200 Liberty Street
New York, New York 10281
(212) 786-1000

Counsel for Petitioner
Shiseido Cosmetics (America) Ltd.

APPENDICES

Appendix A

IN THE

SUPREME COURT OF THE STATE OF CALIFORNIA

IN BANK

Third Appellate District No. C008051/C009273
S023863

Filed February 20, 1992

SHISEIDO COSMETICS (AMERICA) LTD.,

Appellant

—v.—

FRANCHISE TAX BOARD,

Respondent

Appellant's petition for review DENIED.

The request for an order directing publication of the opinion is denied.

BAXTER
Acting Chief Justice

Appendix B

CERTIFIED FOR PARTIAL PUBLICATION*

IN THE

COURT OF APPEAL OF THE STATE OF CALIFORNIA

THIRD APPELLATE DISTRICT

(Sacramento)

SHISEIDO COSMETICS (AMERICA) LTD., *Plaintiff and Appellant,*	)	C008051 C009273
—v.—	)	(Super.Ct.Nos. 336238, 512689)
FRANCHISE TAX BOARD, *Defendant and Respondent.*	)	

APPEAL from judgments of the Superior Court of Sacramento County, Jeffrey L. Gunther and Ronald B. Robie, Judges. Affirmed.

McDonough, Holland & Allen, Richard E. Brandt and Robert R. Rubin for Plaintiff and Appellant.

Daniel E. Lungren, Attorney General, James B. Cuneo, Supervising Deputy Attorney General, and John D. Schell, Deputy Attorney General for Defendant and Respondent.

* All portions of this opinion are certified for publication with the exception of parts II, III and IV of the Discussion.

In these cases consolidated for appeal, plaintiff Shiseido Cosmetics (America) Ltd. ("SCA") sought refund of franchise taxes resulting from defendant Franchise Tax Board ("FTB") assessments applying the unitary tax method of worldwide combined reporting (WWCR) (Rev. & Tax. Code,[1] § 25101 et seq.) based on the determination that SCA was engaged in a unitary business with Shiseido Co., Ltd. ("Shiseido"), its Japanese parent company, and Shiseido's subsidiaries and affiliates located throughout the world. SCA claimed the application of WWCR violates the United States Constitution.

Both lawsuits involve tax years 1971 through 1975. In the first action, the trial court granted summary judgment in FTB's favor on the ground that SCA failed to exhaust administrative remedies by failing to file a postpayment administrative refund claim before filing suit.

SCA filed the second action after submitting a "perfected" refund claim to FTB for the same tax years that were at issue in the first lawsuit. The trial court granted FTB's motion for judgment on the pleadings in the second suit, on the ground the refund claim was untimely.

SCA appeals from both judgments, contending (1) exhaustion of administrative remedies does not apply, because its action raised only constitutional claims, beyond FTB's jurisdiction; (2) SCA sufficiently complied with the claim filing requirement; (3) FTB should be estopped from urging the exhaustion doctrine because its original answer to the first lawsuit admitted the allegation that SCA had exhausted administrative remedies; (4) the doctrine of equitable tolling served to toll the time within which SCA had to file a claim for refund; and (5) the trial court abused its discretion in allowing FTB to amend its answer to deny that SCA had exhausted administrative remedies.

In this published portion of the opinion we will conclude (1) SCA's constitutional claims are not exempt from the statutory requirement that SCA file a claim for refund; and (2)

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1 Undesignated statutory references are to the Revenue and Taxation Code.

no sufficient refund claim was filed. In an unpublished portion of the opinion, we reject SCA's remaining contentions. We will therefore affirm the judgments.

FACTUAL AND PROCEDURAL BACKGROUND

In December 1978, SCA protested notices of proposed FTB assessments for tax years 1971 to 1975 based on Shiseido's worldwide operations, on the ground such assessment imposed a tax on companies not doing business in California or the United States, and on income from sources outside of California. The protest, filed under section 25137,[2] stated the proposed assessments were contrary to the statutes (§§ 25101, 25102) and "in contravention of the Commerce Clause and Foreign Relations Clause of the United States Constitution and the Due Process Clause of the Fourteenth Amendment to the United States Constitution and the Treaty of Friendship, Commerce and Navigation between the United States and Japan."[3]

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2 Section 25137 provides: "If the allocation and apportionment provisions of this act do not fairly represent the extent of the taxpayer's business activity in this state, the taxpayer may petition for or [FTB] may require, in respect to all or any part of the taxpayer's business activity, if reasonable: [¶] (a) Separate accounting; [¶] (b) The exclusion of any one or more of the factors; [¶] (c) The inclusion of one or more additional factors which will fairly represent the taxpayer's business activity in this state; or [¶] (d) The employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income."

3 SCA's opening brief cites our decision in Barclays Bank International Ltd. v. Franchise Tax Bd. (1990) 225 Cal.App.3d 1342, holding the unitary tax method of WWCR, as applied to foreign-based unitary groups, is unconstitutional under the foreign Commerce Clause of the United States Constitution. However, after SCA filed its brief, the California Supreme Court on February 28, 1991, granted review in that case.

We also note that, effective 1988, new legislation allows qualified taxpayers to elect a "water's edge" method for determining taxable income as an alternative to the WWCR method. (§ 25110 et seq.; Stats. 1986, ch. 660, § 6, p. 2213 operative Jan. 1, 1988.) The new legislation is not at issue in this case.

Apparently, the protest was unsuccessful, because in February 1980, SCA petitioned the State Board of Equalization (SBE) for redetermination. (§ 25667.)

In June 1980, FTB and SCA stipulated to remove the administrative appeal from SBE's active calendar pending the outcome of litigation by other taxpayers on the constitutional issue. In March 1984, SBE wrote to SCA requesting points and authorities, in light of a United States Supreme Court case[4] assertedly deciding the issue in FTB's favor. SCA responded that the United States Supreme Court had expressly declined to address the applicability of its decision to state taxation of domestic (United States) corporations with foreign (non-United States) parents or foreign subsidiaries.

On May 18, 1984, SBE replied: "We gather that you are heavily relying upon constitutional arguments which would essentially place this matter beyond the decision-making authority of our Board. If you are willing to concede all but the constitutional arguments and would stipulate with the Franchise Tax Board that the first final reported appellate decision on the constitutional issue in either of the two pending California court actions, i.e. *Alcan Aluminum Corporation* and *Beecham, Inc.*, would be totally binding and dispositive of the appeal, we would have a firm basis for a continued deferral."

SCA wrote back that three classes of issues were involved: (1) constitutionality of utilization of the unitary business approach to taxation of corporate groups with non-United States parent companies; (2) whether the business of the local company, i.e., SCA, and the business of its foreign affiliates constitute a unitary business; and (3) assuming a unitary business and the constitutionality of the unitary business approach, whether the figures used by FTB correctly represented the tax base properly allocable to California.

SCA was willing to bind itself to the first legislative or judicial decision on the constitutional issue and to stipulate, for purposes of the appeal, to being a unitary business. How-

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4 Container Corp. v. Franchise Tax Bd. (1983) 463 U.S. 159 [77 L.Ed.2d 545].

ever, it wanted to leave open the third issue, so that in the event FTB's tax approach was upheld, SCA could challenge FTB's calculations, which were based on figures taken from Moody's OTC Industrial Manual.

SBE informed SCA that FTB had objected to the continued deferral of the cases, because decision on the constitutional issues in the near future was remote, and facts relating to calculations tend to become lost or otherwise unavailable over time. Consequently, SBE set a date for filing of memoranda.

In April 1985, SCA withdrew its fact-based claims, stating in part: "[SCA] has decided not to contest the issues of whether its business constituted a unitary business together with that of its corporate parent, Shiseido Co., Ltd. of Tokyo, Japan and whether the amounts allocated and apportioned to California represent a proper allocation and apportionment of the tax base of the business to California for the years before [SBE] at this time. [¶] The only issue remaining is the issue of whether the State of California has the legal right under the applicable provisions of the United States Constitution to impose the unitary basis of taxation on corporations incorporated in one of the United States, which have a non-United States parent company by bringing into the tax base the financial status and results of that non-United States parent company. That issue, as we both agree, is one which is beyond the jurisdiction of [SBE] under Section 3.5 of Article III of the Constitution of the State of California.[5] [¶] Accordingly, [SCA] has decided not to file a memorandum or oppose the entry of a decision by [SBE]

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5 California Constitution, article III, section 3.5, adopted in 1978, provides: "An administrative agency, including an administrative agency created by the Constitution or an initiative statute, has no power: [¶] (a) To declare a statute unenforceable, or refuse to enforce a statute, on the basis of it being unconstitutional unless an appellate court has made a determination that such statute is unconstitutional; [¶] (b) To declare a statute unconstitutional; [¶] (c) To declare a statute unenforceable, or to refuse to enforce a statute on the basis that federal law or federal regulations prohibit the enforcement of such statute unless an appellate court has made a determination that the enforcement of such statute is prohibited by federal law or federal regulations."

assessing additional franchise tax for the years in question as proposed by [FTB], subject to the reservation of its rights to pursue in the appropriate forum its claims under the United States Constitution as indicated above."

SBE sent a copy of SCA's April 1985 letter to FTB. In June 1985, SBE entered its decision sustaining FTB action on the protest against the proposed assessments and stating in part: "[SCA]'s decision not to contest the issues of whether [its] business constituted a unitary business with that of its corporate parent [ ], and whether the amounts allocated and apportioned to California represent a proper allocation and apportionment of the tax base of the business to California for the years at issue, left only a constitutional issue before the Board. The Board determined that section 3.5 of Article III of the California Constitution precludes it from deciding the constitutional issue."

In November 1985, SCA paid the tax and interest. The checkstubs and transmittal letter stated: "Paid under protest." Counsel for SCA later declared it had been his opinion, based on unspecified FTB public pronouncements and an unspecified conversation with an FTB director, that filing a claim for refund would be a futile act. According to a later statement by an FTB director, "The ordinary practice of the [FTB] upon receipt of such correspondence is to note its receipt and route it to the Claims Section for review. A clerk in the Claims Section refers it to an auditor for determination as to whether a valid claim has been filed. In our normal practice, these statements are not viewed as a valid claim. However, an inquiry would normally be sent to the taxpayer querying whether a claim was intended and indicating that a valid claim was not filed because no grounds were specified as to why a refund should be allowed. A reasonable opportunity is then provided to perfect such documents to a claim for refund. We have no evidence that any of these steps were undertaken in this case."

In January 1986, SCA filed a verified complaint, limiting the alleged ground for refund to its claim that the application of WWCR to a foreign parent unitary business violated the Due Process and Commerce Clauses of the United States

Constitution, the laws of the United States, and the treaty of Friendship, Commerce and Navigation between the United States and Japan.

FTB's original answer to the complaint, filed in March 1986, admitted the complaint's allegation that SCA had timely exhausted all administrative remedies.

The parties obtained stipulations of fact used in similar litigation, then spent the next two years negotiating a set of stipulated facts to submit the case for judicial decision.

During the course of preparing the stipulation, FTB's counsel discovered in January 1989 that his file did not contain a postpayment refund claim document sufficient to support FTB's admission that SCA had exhausted all administrative remedies. FTB served discovery upon SCA designed to establish that SCA had not filed a claim for refund after payment of the tax and before filing the court action. When asked to produce "Each and every document comprising the claims for refund of California [FTB] by [SCA] for the years ending November of 1970, 1971, 1972, 1973, and 1974, or any of said years," SCA's attorney responded in March 1989 that "SCA has no such documents in its possession." In May 1989, SCA objected to further discovery on the ground that "The subject matter of the request is not relevant and cannot lead to the discovery of any relevant evidence. By reason of admissions in the Answer to Complaint, the issue of exhaustion of administrative remedies has been removed from this case."

FTB successfully moved to compel discovery, the trial court concluding in June 1989 that exhaustion of remedies is jurisdictional and may be raised at any time.

In June 1989, FTB moved to amend its answer, on the grounds of inadvertence and mistake. SCA opposed the motion on the grounds that (1) FTB's delay in raising the failure to file a refund claim was prejudicial, because SCA would have had time to file a formal claim had FTB's original answer denied the allegation of exhaustion of administrative remedies; (2) FTB failed to show any mistake justifying amendment; and (3) FTB's delay in filing the motion to

amend was due to a lack of diligence. The trial court granted the motion.

Also in June 1989, SCA filed its "perfected" claim for refund, which referred to and incorporated the prior communications regarding SCA's constitutional claim and did not raise any new issues.

In September 1989, FTB filed a motion for summary judgment on the grounds that (1) SCA had not filed a timely claim for refund; (2) a refund claim is a jurisdictional prerequisite to a lawsuit; and (3) the failure to file a claim is not subject to exceptions by reason of waiver or estoppel. SCA opposed the summary judgment motion on the grounds that (1) its conduct sufficiently comprised an informal claim, which tolled the limitations period until the 1989 filing of the formal claim, and (2) FTB should be estopped by its original answer admitting that administrative remedies had been exhausted.

In December 1989, the trial court granted FTB's motion for summary judgment. The order states in part: "There is no triable issue of material fact re plaintiff's failure to file a refund claim. Also, estoppel is not applicable. [ ]"

SCA appealed the summary judgment and in February 1990 filed the second lawsuit, which referred to the first lawsuit and sought the same relief, but in reliance on the 1989 refund claim.

In May 1990, FTB moved for judgment on the pleadings. In granting the motion, the trial court ruled that (1) the June 1989 refund claim was untimely; (2) SCA's November 1985 letter and checkstubs "paid under protest" did not state reasons for a refund and could not be considered a request for refund; (3) FTB could not be estopped from denying that SCA had exhausted its administrative remedies, and (4) SCA could not rely on the doctrine of equitable tolling of the time within which to file a refund claim because it was simply another form of estoppel.

SCA appeals from the judgments in both actions.

DISCUSSION

I. *An Administrative Claim For Tax Refund Was A Jurisdictional Prerequisite To The Lawsuit*

A. *The Applicable Procedure*

In order to challenge a state franchise tax, the taxpayer must first pay the tax, then follow statutory procedures for recovery. Thus, California Constitution, article XIII, section 32, (hereafter article XIII, § 32) provides: "No legal or equitable process shall issue in any proceeding in any court against this State or any officer thereof to prevent or enjoin the collection of any tax. After payment of a tax claimed to be illegal, an action may be maintained to recover the tax paid, with interest, *in such manner as may be provided by the Legislature.*" (Emphasis added.)

The state Constitution also provides that "The Legislature shall pass all laws necessary to carry out the provisions of this article" (Cal. Const., art. XIII, § 33) and that "Suits may be brought against the state in such manner and in such courts as shall be directed by law" (Cal. Const., art. III, § 5).

Pursuant to this constitutional authority, the Legislature has provided the procedures for suits for franchise tax refunds in sections 26101 through 26107.

Section 26102 provides: "Except as provided in Section 26103a [FTB failure to act on refund claim], after payment of the tax and denial by [FTB] of a claim for refund, any taxpayer claiming that the tax computed and assessed against it under this part is void in whole or in part may bring an action, upon the grounds set forth in its claim for refund, against [FTB] for the recovery of the whole or any part of the amount paid."

Section 26103 provides: "The action provided by Section 26102 shall be filed within four years from the last date prescribed for filing the return or within one year from the date the tax was paid, or within 90 days after (a) notice of action by [FTB] upon any claim for refund, or (b) notice of action

by [SBE] on an appeal from the action of [FTB] on a claim for refund, whichever period expires the later."

Section 26103b states: "Failure to begin an action within the time specified in this article shall be a bar against the recovery of taxes."

Section 26073 provides: "No credit or refund shall be allowed or made after four years from the last day prescribed for filing the return or after one year from the date of the overpayment, whichever period expires the later, unless before the expiration of the period a claim therefor is filed by the taxpayer, or unless before the expiration of the period [FTB] allowed a credit, made a refund, mailed a notice of proposed overpayment on a preprinted form prescribed by [FTB], or certified the overpayment to the State Board of Control for approval of the refunding thereof."

Section 26074, at the time in question, provided: "Every claim for refund shall be in writing and state the specific grounds upon which it is founded."[6]

B. *SCA's Constitutional Claim Is Not Exempt From The Refund Claim Filing Requirement*

SCA contends it "exhausted its administrative remedies by its [prepayment] protest to FTB and appeal to SBE, and was not required to file a formal post-payment claim with FTB, because FTB was precluded by article III, section 3.5 of the California Constitution [fn. 5, *ante*] and SBE's decision from considering or granting relief based on SCA's claim after SCA had limited the claim to the issue of whether WWCR violated the United States Constitution." We disagree.

The trial court correctly relied on Patane v. Kiddoo (1985) 167 Cal.App.3d 1207, in which we held that the constitutional source of legislative power to control tax refund suits required strict adherence to the administrative procedures set forth by the Legislature before a court action could be filed.

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6 A 1986 amendment, effective September 22, 1986, requires that the claim be signed by the taxpayer or the taxpayer's authorized representative, and adds provisions relating to claims filed on behalf of a class of taxpayers. (Stats. 1986, ch. 931, § 6.)

In *Patane*, the taxpayer instituted an action for refund of taxes which he claimed were illegally assessed and collected by the Employment Development Department as unemployment insurance contributions. The taxpayer had protested the assessment on the ground the share farmers he hired were independent contractors rather than employees. An administrative law judge agreed, but the tax assessment was reinstated upon the department's appeal to the Unemployment Insurance Appeals Board. The taxpayer paid the tax, then filed a claim for refund, which was denied. (*Id.* at p. 1210.) The taxpayer did not complete the administrative appeal process required by the Unemployment Insurance Code. In affirming summary judgment in favor of the department, we said: "Because article XIII, section 32, of the Constitution permits tax refund suits only 'in such manner as may be provided by the legislature,' plaintiff's failure to satisfy a statutory condition to suit is fatal to his action . . . ." (*Id.* at pp. 1213-1214.)

The taxpayer in *Patane* argued he should be excused from the exhaustion requirement, because any appeal would inevitably have been decided adversely to him in light of the board's previous determination of the same issues in the department's successful appeal from the prior granting of the taxpayer's petition for reassessment. (*Id.* at p. 1214.) We rejected that argument and held as follows:

"The doctrine of exhaustion of administrative remedies was evolved by the courts to promote comity between coequal branches of government and to relieve overburdened courts from the need to deal with cases where effective administrative remedies are available. (*Bozaich* v. *State of California* (1973) 32 Cal.App.3d 688, 698 [ ].) The judicially developed rule and, perforce, its exceptions, have no application to an action to recover a tax paid. Although exhaustion of administrative remedies is prerequisite to such an action, it is compelled not by the judicially created doctrine of comity and convenience but by the constitutional grant of power to the Legislature to prescribe the manner of proceeding in such cases. [Unemployment Insurance Code sections] implement the constitutional provision and impose as a condition to the

maintenance of an action to recover unemployment insurance taxes the exhaustion of administrative remedies. We are not at liberty to alter the constitutionally authorized process by engrafting onto it exceptions borrowed from the judicially fashioned doctrine of exhaustion of administrative remedies. The authority to make such changes is confided in the Legislature by article XIII, section 32, of the Constitution, a provision which, as we have recently been reminded by our high court, 'means what it says.' (*Pacific Gas & Electric Co.* v. *State Bd. of Equalization* (1980) 27 Cal.3d 277, 284 [ ].)" (*Patane*, supra, 167 Cal.App.3d at p. 1214.)

SCA contends *Patane* is distinguishable because here article III, section 3.5 of the state Constitution (fn. 5, *ante*) divested FTB of jurisdiction to grant SCA relief by declaring the taxing statutes unconstitutional.

This argument is unmeritorious. As we pointed out in *Patane*, we are without authority to alter the statutory procedures for tax refunds enacted by the Legislature pursuant to the state constitutional command of article XIII, section 32. SCA has made no direct federal constitutional attack on those statutes but, in any event, the claim-of-refund statutes have a rational basis. The claim of refund, filed in advance of litigation (§ 26102), provides the state with official notice that a taxpayer will make a claim for moneys paid to the treasury. Because the refund claim must state "the specific grounds upon which it is founded" (§ 26074), the claim of refund allows the state to evaluate the merits of the taxpayer's claim and to plan fiscal policy accordingly. This salutary purpose of a claim of refund exists even though FTB is without power to adjudicate the refund claim in the taxpayer's favor. We therefore conclude SCA was obligated to follow statutory procedures requiring that a claim for refund be filed and denied in advance of litigation. (*Patane*, supra, 167 Cal.App.3d at p. 1214.)[7]

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7 Because we arrive at this conclusion for the reasons stated, we have no occasion to consider FTB's argument that exhaustion of administrative remedies was appropriate to make a record for judicial review. (See County of Contra Costa v. State of California (1986) 177 Cal.App.3d 62, 75, fn. 8.)

SCA cites our prior decisions in Southern Pacific Transportation Co. v. State Bd. of Equalization (1987) 191 Cal.App.3d 938 and Duffy v. State Bd. of Equalization (1984) 152 Cal.App.3d 1156. In *Southern Pacific*, valuation of the taxpayer's property was at issue. Although six separate methods of valuation (plus their combinations) were potentially at issue in the case, the taxpayer was given no notice of the method or methods used by the Board. We concluded that since the taxpayer was given no notice of the method(s) used, the taxpayer did not fail to exhaust administrative remedies by failing to challenge some of the methods before the Board. (*Southern Pacific*, supra, 191 Cal.App.3d at p. 945, fn. 3.)

In *Duffy*, the taxpayer was a tailor who performed initial alterations on clothing bought elsewhere. He challenged a regulation specifying tax was due on alterations to "new clothing." He claimed none of the clothing brought to his shop was "new." We concluded the taxpayer did not fail to exhaust his administrative remedies by refusing to provide business records and by refusing to cooperate in an experiment suggested by the Board, because the Board's requests were irrelevant to the taxpayer's "distilled contentions of law" that none of his alterations were done on "new clothing." (*Id.* at p. 1163.)

Unlike this case, neither *Southern Pacific* nor *Duffy* represented an attempt by the taxpayer to evade any statutory procedure enacted by the Legislature pursuant to constitutional command. Rather, each case concerned the way the existing administrative process should accommodate issues framed by the taxpayer's challenge. The cases are therefore inapposite.

SCA argues its case is analogous to Park 'N Fly of San Francisco, Inc. v. City of South San Francisco (1987) 188 Cal.App.3d 1201. That case involved a local ordinance imposing a business license tax on operators of commercial parking facilities. The appellate court held the taxpayer's failure to exhaust administrative remedies on the issue of its classification as a commercial parking facility precluded its challenging that classification on appeal. (*Id.* at pp. 1207-1208.) The court remarked, "The exhaustion doctrine does

not, however, preclude consideration of appellant's constitutional objections to the ordinance, which provides the taxpayer with no mechanism either for challenging its essential validity or raising constitutional questions. Where no forum or administrative remedy is afforded for the issues raised, recourse to the local administrative agency is not required before initiation of court action. . . ." (*Id.* at pp. 1208-1209.)

Because *Park 'N Fly* involved a local ordinance and local agencies, the constitutional command of article XIII, section 32 was not at issue. Article XIII, section 32 applies only to actions against the state. (Pacific Gas & Electric Co. v. State Bd. of Equalization (1980) 27 Cal.3d 277, 281, fn. 6; A&M Records, Inc. v. State Bd. of Equalization (1988) 204 Cal.App.3d 358, 369.) Because *Park 'N Fly*, like *Southern Pacific* and *Duffy*, involved no transgression of constitutionally mandated statutes, the case is inapplicable here.

SCA also cites Pacific Motor Transport Co. v. State Bd. of Equalization (1972) 28 Cal.App.3d 230 as supposedly recognizing an exception to the claim filing requirement where the taxpayer challenges the validity of the tax. There, the taxpayers brought an action to determine the validity of, and for a declaration of their rights and duties, under a tax regulation. The action was brought under Government Code section 11440, providing for judicial declaration as to the validity of administrative regulations. The appellate court reconciled that statute with the applicable Revenue and Taxation Code prohibition against judicial interference with tax collection by holding the taxpayers could obtain a judicial declaration as to the validity of the regulation but could not obtain the other relief requested, i.e., a declaration of the regulation's applicability to them or of their resulting tax liability. (*Id.* at pp. 234, 236.) Here, SCA's action was for recovery of taxes under section 26102. It sought a refund, not a mere declaration of validity; and it challenged a statute, not a regulation. Thus, *Pacific Motor* does not apply to this case.

C. No Sufficient Claim Was Filed

In this case, SCA was required to file a refund claim, specifying grounds for the claim, by November 1986, one year after payment of the taxes. (§§ 26073-26074.) SCA argues a sufficient refund claim can be pieced together by considering (1) its prepayment protest and appeal, (2) its writing "paid under protest" on its payment, and (3) its filing of the first lawsuit within the one year limitations period for filing the administrative claim. According to SCA, these factors together constituted at least an informal claim, which it "perfected" by filing its formal claim in 1989.

SCA's piecemeal approach does not work. First, the prepayment protest and appeal cannot be considered a claim for refund. Contrary to SCA's assertion, the refund claim must be filed *after* payment of the tax (§ 26102). A prepayment protest or appeal is treated as a refund claim only if the tax is paid before administrative action on the protest or appeal. Thus, section 26078 provides: "If, with or after filing a protest or an appeal to the board, a taxpayer pays the tax protested *before* [FTB] acts upon the protest or the board on the appeal, the protest or appeal shall be treated as a claim for refund or an appeal from the denial of a claim for refund under this article." (Emphasis added.) And under section 26079, "A refund claim upon which action has become final is not thereafter a refund claim except to the extent allowed."

Here, the SBE appeal was final July 25, 1985, 30 days after the decision. (18 Cal.Code Regs., § 5037.) The tax was paid in November 1985. Since the tax was paid after the protest and appeal were final, the protest and appeal proceedings cannot be considered a claim for refund.

SCA misreads Newman v. Franchise Tax Bd. (1989) 208 Cal.App.3d 972 as holding that a prepayment protest letter may constitute a refund claim. The letter at issue in *Newman*, though entitled "protest," was a *post*payment communication, in which the taxpayers asserted they had overreported income on their original return for the year in question. (*Id.* at p. 979.)

Similarly, SCA incorrectly cites Wallace Berrie & Co. v. State Bd. of Equalization (1985) 40 Cal.3d 60, as construing prepayment correspondence to constitute an informal claim where the board understands the taxpayer is seeking a refund. In that case, however, a refund claim had been filed. (*Id.* at p. 66, fn. 2.) In commenting on the question whether a particular issue had been raised in the claim, our Supreme Court found the issue had been at least indirectly raised, and the board had litigated the issue "head on" during trial. (*Ibid.*) Thus, the board's conduct supported the conclusion that the issue had been raised in the refund claim. *Wallace Berrie* has no application to this case, where there was no refund claim.

We conclude SCA's prepayment protest and appeal do not constitute a refund claim.

SCA wrote "paid under protest" on its payment. However, these words do not constitute a valid refund claim, since they do not demand a refund or specify grounds for a refund. (§ 26074; Mercury Casualty Co. v. State Bd. of Equalization (1986) 179 Cal.App.3d 34, 40.) Nor does FTB's knowledge of the circumstances surrounding the claim excuse compliance with the refund claim requirement. " 'It is well-settled that claims statutes must be satisfied even in face of the public entity's actual knowledge of the circumstances surrounding the claim. Such knowledge—standing alone—constitutes neither substantial compliance nor basis for estoppel. [Citations.]' " (*Mercury Casualty Co.*, supra, at p. 40.)

We therefore reject SCA's contention that the prepayment proceedings, followed by payment "under protest," satisfied the statutory refund claim filing requirements. (*Ibid.*)

SCA's third asserted claim component—the filing of the lawsuit—adds nothing to the analysis. As FTB puts it, the complaint "cannot constitute the document which is prerequisite to its existence." We will not consider the complaint as supplying the grounds omitted from the payment "under protest." To do so would contravene the Legislature's com-

mand, in section 26102, that a legal action may be brought only after denial of a claim for refund.[8]

SCA relies on FTB Legal Ruling 386 (Cal. Tax Rptr. (CCH Transfer Binder 1971 1978) ¶ 205-319 (Aug. 25, 1975)) which provides in pertinent part as follows: "If it is clear that the taxpayer seeks a refund, but that the refund request lacks sufficient specificity to apprise the Franchise Tax Board of the exact basis of the claim, the refund request is considered an 'informal' claim for refund (see *Clement* v. *United States*, 472 Fed.2d 776 (1973); *United States* v. *Kales*, 314 U.S. 186, 86 Law.Fd. 132, 62 Sup.Ct. (1941)). Informal claims toll the statute of limitations. . . . [If an] informal claim is substantiated by a later amendment which refers to the defective claim (*Appeal of Clarence L. and A. Lois Morey, supra*; *Tobin* v. *Tomlinson*, 310 Fed.2d 648 (1962)) and which is limited to clarifying the original grounds rather than adding new ones (Bear Valley Mutual Water Company v. Riddell, 493 Fed.2d 948 (1974); *Sappington* v. *United States*, 408 Fed.2d 817 (1969)), the taxpayer [can] . . . institute a legal action (Revenue and Taxation Code Sections 19082, 26102)."

This ruling may well provide guidance for handling refund claims that inartfully specify the specific ground for refund. But nothing in this ruling purports to authorize as valid a refund claim that fails to meet the essential statutory criteria. Indeed, it goes without saying that FTB has no such power. Here, as we have recounted, SCA's purported piecemeal claim for refund failed to satisfy the applicable statutes in several respects. SCA cannot avoid these statutory shortcomings by characterizing its actions as an "informal claim for refund."

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8 Nor can the complaint in the first lawsuit constitute an informal claim for purposes of the second lawsuit. Even assuming for the sake of argument the complaint in the first action could be regarded, as an informal claim for the second lawsuit, then FTB's answer to the complaint in the first lawsuit, filed in March 1986 and denying that SCA was entitled to a refund, must be regarded as a denial of that claim. Hence, the filing of the second lawsuit some four years later was untimely. (§ 26102.)

SCA also cites various federal cases that have construed claims for refund in favor of the taxpayer under federal tax laws.[9]

Thus, in United States v. Kales (1941) 314 U.S. 186 [86 L.Ed. 132] the taxpayer sent a letter of "protest" to the Commissioner detailing the legal bases upon which the taxpayer "will claim the right to a refund." The Supreme Court concluded, "Such a use of the future tense in stating a claim may, with due regard to the circumstances of making it, rightly be taken as an assertion of a present right. [Citations.]" (*Id.* 314 U.S. at p. 196 [86 L.Ed. at p. 139].) The letter of protest at issue in *Kales* is distinguishable from SCA's payment under protest in this case because the *Kales* protest (a) detailed the legal basis for the claim and (b) stated a refund was sought. *Kales* does not aid SCA.

In American Radiator & Standard San. Corp. v. United States (Ct. Claims 1963) 318 F.2d 915, the court concluded the legal basis for a tax refund claim was learned by an agent of Internal Revenue Service when he audited the taxpayer's tax returns. (*Id.* at p. 921.) We cannot reconcile *American Radiator* with the applicable California statute, section 26074, which expressly requires a refund claim to be in writ-

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9 Notably 26 United States Code section 7422(a) which provides in pertinent part: "No suit or proceeding shall be maintained in any court for the recovery of any internal revenue tax alleged to have been erroneously or illegally assessed or collected . . . until a claim for refund or credit has been duly filed with the Secretary, according to the provisions of law in that regard, and the regulations of the Secretary established in pursuance thereof."

The regulations of the Secretary referred to in section 7422(a) are set forth in Treasury Regulation section (26 C.F.R. § 301.6402-2 (b) (1991)), which provides:

"No refund or credit will be allowed after the expiration of the statutory period of limitation applicable to the filing of a claim therefor except upon one or more of the grounds set forth in a claim filed before the expiration of such period. The claim must set forth in detail each ground upon which a credit or refund is claimed and facts sufficient to apprise the Commissioner of the exact basis thereof. The statement of the grounds and facts must be verified by a written declaration that it is made under the penalties of perjury. A claim which does not comply with this paragraph will not be considered for any purpose as a claim for refund or credit."

ing and to state the specific grounds upon which it is founded. We therefore decline to follow *American Radiator* and will follow Mercury Casualty Co. v. State Bd. of Equalization, supra, 179 Cal.App.3d at page 40 on this point.

Similarly, in Newton v. United States (Ct. Claims 1958) 163 F.Supp. 614, the court concluded a valid informal claim for refund was made prior to the time the tax was paid. (*Id.* at p. 619.) However, as we have explained, the applicable California statutes plainly require that the tax be paid before a claim for refund may be filed. (§§ 26078, 26102.)

In Night Hawk Leasing Co. v. United States (Ct. Claims 1937) 18 F.Supp. 938, the court treated as a valid claim for refund the following notation on the back of the taxpayer's check: " 'This check is accepted as paid under protest pending final decision of the higher courts.' " (P. 940.) This notation is arguably distinguishable from SCA's "paid under protest" notation in that the *Night Hawk* notation referred to litigation from which the legal basis of the taxpayer's claim could be ascertained. However, to the extent the case suggests that an unadorned payment under protest (such as that submitted by SCA) may satisfy the requirements of section 26074, we respectfully decline to follow it and will continue to follow Mercury Casualty Co. v. State Bd. of Equalization, supra, 179 Cal.App.3d at page 40.

Finally, we are mindful of the effect of our decision on the administration of the tax laws. The applicable statutes requiring filing of a claim for refund are clear and straightforward. The filing of a claim for refund is "a simple and unburdensome act." (179 Cal.App.3d at p. 41.) We are unwilling to construe the simple, straightforward statutory requirements in ways that would leave tax authorities in doubt as to whether refund claims have been filed and promote undesirable litigation.

We conclude SCA's tax refund suit is barred for failure to exhaust constitutionally compelled administrative remedies. (179 Cal.App.3d at pp. 40-41; Patane v. Kiddoo, supra, 167 Cal.App.3d at pp. 1213-1214.)

II. *No Facts Support Estoppel*

SCA contends FTB should be estopped from denying that SCA exhausted its administrative remedies because FTB initially admitted in its answer that SCA had exhausted.

The parties dispute whether the doctrine of estoppel is available at all here, where the taxpayer's failure to follow constitutionally-mandated statutory procedures is at issue. We will not resolve that question. Even assuming for the sake of argument the estoppel doctrine is available in this context, the facts show without dispute no estoppel is available. Although application of the estoppel doctrine is ordinarily a question of fact, the issue may be resolved on summary judgment where the facts are undisputed. (Page v. City of Montebello (1980) 112 Cal.App.3d 658, 665-666.)

Our Supreme Court recently discussed the application of estoppel against public entities, as follows:

"The modern doctrine of equitable estoppel is a descendant of the ancient equity doctrine that 'if a representation be made to another who deals upon the faith of it, the former must make the representation good if he knew or was bound to know it to be false.' [Citations.] We have described the requirements for the application of equitable estoppel as follows: ' "Generally speaking, four elements must be present . . . : (1) the party to be estopped must be apprised of the facts; (2) he must intend that his conduct shall be acted upon, or must so act that the party asserting the estoppel had a right to believe it was so intended; (3) *the other party must be ignorant of the true state of facts*; and (4) he must rely upon the conduct to his injury." ' [Citations.]" (Lentz v. McMahon (1989) 49 Cal.3d 393, 398-399, emphasis added [equitable estoppel applies against county welfare agencies].)

There can be no estoppel where one of the requisite elements is missing. (Green v. Travelers Indemnity Co. (1986) 185 Cal.App.3d 544, 556; Central National Ins. Co. v. California Ins. Guarantee Assn. (1985) 165 Cal.App.3d 453, 459; Pinewood Investors v. City of Oxnard (1982) 133 Cal.App.3d 1030, 1036; Hill v. Kaiser Aetna (1982) 130 Cal.App.3d 188,

195; 11 Witkin, Summary of Cal. Law (9th ed. 1990) Equity, § 177, p. 859.)

There can be no estoppel in this case, because SCA was not ignorant of the true state of the facts. Thus, SCA at all times knew what it had filed and what it had not filed with FTB. SCA at all times knew it had not filed a refund claim. Its initial discovery responses said it did not have in its possession any documents comprising a refund claim. Indeed, the undisputed evidence shows SCA's attorney made a conscious decision not to file a claim because it was his understanding that a refund claim would be a futile act. Although the attorney's understanding was assertedly based on information from FTB, SCA does not seriously contend that FTB made any misrepresentations or show evidence of any specific statements by FTB.

SCA tries to avoid its own knowledge by saying the facts of which it was ignorant were (1) that FTB had not searched its own file for a sufficient claim document before answering the complaint, and (2) that FTB would have denied SCA's allegation of exhaustion had FTB searched its file. However, these are clearly not the material facts in the estoppel determination. In seeking to estop FTB from asserting SCA's failure to exhaust administrative remedies, the material fact was that SCA had not filed a refund claim. That failure was well known to SCA.

Because SCA was not ignorant of the true state of facts, an estoppel will not lie as a matter of law. (See Cal. Cigarette Concessions v. City of L.A. (1960) 53 Cal.2d 865, 870.)

III. *The Time For Filing a Claim For Refund Was Not Tolled By the Filing of SCA's First Action*

SCA contends, "Pursuant to the equitable tolling doctrine, the time for SCA to file a claim should be deemed to have been tolled from the time of FTB's original Answer in Action 336238 until FTB raised its defense that SCA had failed to exhaust its administrative remedies. If the time from FTB's judicial admission until the time the defense was raised is excluded, SCA filed its second suit for refund within one

year of the payment of the tax and within 90 days after its perfected claim of June 29, 1989, was deemed denied. Thus, Action 512689 was timely filed under Revenue and Taxation Code Section 26103."

SCA relies on Bollinger v. National Fire Ins. Co. (1944) 25 Cal.2d 399. There, plaintiff sued an insurer for a loss under a fire insurance policy. The case proceeded to trial and, at the conclusion of plaintiff's case, the trial court granted a nonsuit, on the ground plaintiff had filed his suit prematurely, because he had not waited 30 days after agreement (with the insurer) as to the amount of loss, as required by the terms of the policy. Without appealing, plaintiff filed a second lawsuit asserting the same claim. The insurer successfully demurred to the second suit on the ground it was filed beyond the contractual statute of limitations set forth in the policy (15 months after the fire).

The Supreme Court reversed the judgment of dismissal in the second suit, concluding plaintiff's pursuit of the first action tolled the statute of limitations: "In the present case plaintiff brought his action on the policy in good time and diligently pursued it. The nonsuit was erroneous and unrelated to the merits. But for the unreasonable delay in bringing the action to trial, the limitation period would not have expired and ample time would have remained to file a new action. Since this action is in reality a continuance of the earlier action involving the same parties, facts, and cause of action, and was promptly filed after entry of judgment on the nonsuit, plaintiff should not be deprived of a trial on the merits because he failed to seek other remedies in the municipal court." (*Id.* at pp. 410-411.)

Bollinger is a variation of the doctrine of equitable tolling: "[C]ourts have adhered to a general policy which favors relieving plaintiff from the bar of a limitations statute when, possessing several legal remedies he, reasonably and in good faith, pursues one designed to lessen the extent of his injuries or damage." (Addison v. State of California (1978) 21 Cal.3d 313, 317.)

We doubt whether the courts are empowered to invoke the doctrine of equitable tolling to excuse compliance with consti-

tutionally mandated statutory procedures to sue for a tax refund. (See Patane v. Kiddoo, supra, 167 Cal.App.3d at pp. 1213-1214.) However, even assuming for the sake of argument the doctrine might be available in an appropriate tax case, this is not the case. Here, SCA claims its first complaint should serve to toll the time for filing a refund claim. However, as we have recounted, SCA knew when it filed its complaint that it had not filed a claim for refund. To allow SCA to rely on its complaint would therefore encourage knowing avoidance of the timely pursuit of the constitutionally mandated statutory claim procedure. That result, which would encourage taxpayers to sue without filing timely refund claims, cannot be reconciled with prudent public policy. Bollinger v. National Fire Ins. Co., supra, 25 Cal.2d 399 is distinguishable because, *inter alia*, the case involved equitable tolling of a private contractual statute of limitations. The strong public policy reflected in the statutory refund procedures was not implicated.

We therefore conclude SCA's first complaint did not equitably toll the time for filing a claim for refund.

In a paragraph included in its equitable tolling argument, SCA also contends its second complaint should relate back to the time of filing of its first complaint. For this proposition, SCA cites Bendix Corp. v. City of Los Angeles (1984) 150 Cal.App.3d 921. However, as pointed out in Mercury Casualty Co. v. State Bd. of Equalization, supra, 179 Cal.App.3d 34, *Bendix* involved the filing of a *supplemental* complaint; the relation-back doctrine does not apply where, as here, a separate second complaint was filed. (*Mercury Casualty Co.*, supra, at p. 44.)

IV. *Leave To Amend The Answer Was Proper*

SCA contends the trial court abused its discretion in allowing FTB to amend its answer to allege failure to exhaust administrative remedies, because the trial court mistakenly believed amendment was a matter of right.

The trial court's order granting the motion states: "Exhaustion of administrative remedies is jurisdictional. This ruling is without prejudice to estoppel being raised at trial."

SCA points out the trial court order granting the discovery motion stated the exhaustion issue was jurisdictional and could be raised at any time. From this, SCA concludes the trial court believed the exhaustion doctrine implicated subject matter jurisdiction, such that the court had no choice but to allow amendment. However, that conclusion is contradicted by the court's proviso that estoppel could be raised at trial, because subject matter jurisdiction cannot be conferred by consent or estoppel. (2 Witkin, Cal. Procedure (3d ed. 1985) Jurisdiction, § 10, p. 374.)

SCA acknowledges that Code of Civil Procedure section 473 authorizes liberal amendment of pleadings but claims the moving party must meet a higher burden of justification when the amendment would disavow a judicial admission. We do not, however, view the instant amendment as an amendment of an admission of fact but rather of a mixed question of law and fact. (See Brown v. Aguilar (1927) 202 Cal. 143, 149 [pleader not bound by conclusions of law]; 4 Witkin, Cal. Procedure, op. cit. supra, Pleading, § 406, p. 455.) In any event, as we shall explain, the admission in the answer occurred as a result of mistake and was therefore correctable upon an appropriate showing.

SCA challenges FTB's factual showing. The moving papers included a declaration from the deputy attorney general attesting he was assigned to represent FTB in February 1986, he received the file but without the administrative proceedings, and he relied on FTB counsel in preparing the answer. In reviewing the file in January 1989, the deputy attorney general discovered there was no refund claim. He served a request for production, to which SCA responded in March 1989 that it had no documents comprising a refund claim. In May 1989, he received SCA's response to request for admissions, objecting on the ground the exhaustion issue had been removed from the case by FTB's answer. The motion for leave to amend was filed in June 1989.

In opposition to the motion, SCA's attorney filed a declaration recounting the prepayment proceedings, the payment under protest, and attaching deposition transcripts of FTB personnel. It appears that FTB's counsel, David Hinman, relied on an FTB auditor, Charles Casale, who mistakenly thought a refund claim had been filed. Although SCA selectively cites Casale's remark that he would probably consider the complaint itself to be a refund claim, it is apparent from the deposition that Casale, who did not work in the claims processing unit, simply made a mistake. Amendment to correct a mistake is allowed. (Code Civ. Proc., § 473.)

According to SCA, leave to amend was improper because there was a three-year delay in FTB's raising the exhaustion issue. However, the deputy attorney general declared that he and opposing counsel agreed to put the case on a back burner. (We consider immaterial the parties' dispute over whose idea that was.) When the case geared up again, the parties engaged in negotiating a set of stipulated facts. The focus was on facts and constitutional issues, not procedural matters. In reviewing one of SCA's drafts, the deputy attorney general wanted to ascertain whether certain revisions were covered in the refund claim. That was when he discovered there was no refund claim. Considering all circumstances, SCA fails to show a lack of diligence requiring denial of leave to amend.

SCA says it was prejudiced by the delay in amendment, because if FTB had denied the exhaustion allegation in its original March 1986 answer or sought amendment sooner, SCA would have investigated the denial and would have had ample time to file a formal refund claim before the November 1986 deadline. We conclude, however, that the prejudice to SCA stems primarily from its own failure to investigate the facts before filing its own verified complaint, which alleged it had exhausted administrative remedies.

Liberality should be particularly displayed in allowing amendment of answers because a defendant denied leave is permanently deprived of a defense. (5 Witkin, Cal. Procedure, op. cit. supra, Pleading, § 1121, p. 538.) "The discre-

tion of the trial court should be upheld unless clearly abused." (*Ibid.*)

The trial court did not abuse its discretion in granting leave to amend the answer to assert SCA's failure to exhaust administrative remedies.

DISPOSITION

The judgments are affirmed.

SIMS, J.

We concur:

PUGLIA, P.J.

MARLER, J.

Appendix C

IN THE

COURT OF APPEAL OF THE STATE OF CALIFORNIA

IN AND FOR THE

THIRD APPELLATE DISTRICT

Filed November 14, 1991

SHISEIDO COSMETICS AMERICA LTD.

Plaintiff and Appellant

—vs.—

FRANCHISE TAX BOARD OF STATE OF CALIF.

Defendant and Respondent

3 Civil C008051
Sacramento
336238

SHISEIDO COSMETICS AMERICA LTD.

Plaintiff and Appellant

—vs.—

FRANCHISE TAX BOARD, OF STATE OF CALIF.

Defendant and Respondent

3 Civil C009273
Sacramento
336238

By the Court:

Appellant's petition for rehearing is denied.

Dated: November 14, 1991

PUGLIA, P.J.

cc: See Mailing List

Appendix D

JOHN K. VAN DE KAMP,
Attorney General of the State of California
ROBERT F. TYLER
Supervising Deputy Attorney General
JOHN D. SCHELL, Bar #42573
Deputy Attorney General
1515 K Street, Suite 511
P.O. Box 944255
Sacramento, California 94244-2550
Telephone: (916) 324-5154

Attorneys for Defendant

SUPERIOR COURT OF THE STATE OF CALIFORNIA

FOR THE COUNTY OF SACRAMENTO

SHISEIDO COSMETICS (AMERICA) LTD.	) NO. 336238
Plaintiff,	) JUDGMENT BY COURT
v.	) UNDER CCP § 437c
FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA,	) Date: Dec. 8, 1989) Time: 9:00 a.m.) Dept.: 28
Defendant.	) Judge: Jeffrey L. Gunther

On December 11, 1989, the court granted the motion of defendant Franchise Tax Board of the State of California under Code of Civil Procedure section 437c to enter judgment for defendant. In accordance with that order,

IT IS ORDERED that plaintiff take nothing by reason of its complaint and that defendant recover from plaintiff its costs in the sum of $ _____.

DATED: December 22, 1989

JEFFREY L. GUNTHER
JUDGE OF THE SUPERIOR COURT

JOHN K. VAN DE KAMP,
Attorney General of the State of California
ROBERT F. TYLER
Supervising Deputy Attorney General
JOHN D. SCHELL, Bar #42573
Deputy Attorney General
1515 K Street, Suite 511
P.O. Box 944255
Sacramento, California 94244-2550
Telephone: (916) 324-5154

Attorneys for Defendant

SUPERIOR COURT OF THE STATE OF CALIFORNIA

FOR THE COUNTY OF SACRAMENTO

SHISEIDO COSMETICS (AMERICA) LTD., *Plaintiff*, v. FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA, *Defendant*.	NO. 336238 ORDER GRANTING DEFENDANT'S MOTION FOR SUMMARY JUDGMENT Date: Dec. 8, 1989 Time: 9:00 a.m. Dept.: 28 Judge: Jeffrey L. Gunther

The motion of defendant Franchise Tax Board of the State of California came regularly before the court, the Honorable Jeffrey L. Gunther presiding, at the date and time stated above. Robert R. Rubin and Lloyd De Vos, attorneys, appeared on behalf of plaintiff and John D. Schell, deputy

attorney general, appeared for defendant. After considering the oral and written argument and papers, the court ORDERS:

Defendant's motion for summary judgment granted. There is no triable issue of material fact re plaintiff's failure to file a refund claim. Also, estoppel is not applicable. (See *Patane* v. *Kiddoo* (1987) 167 Cal.App.3d 1207.)

DATED:

JEFFREY L. GUNTHER
Judge of the Superior Court

Appendix E

JOHN K. VAN DE KAMP,
Attorney General of the State of California
ROBERT F. TYLER
Supervising Deputy Attorney General
JOHN D. SCHELL, Bar #42573
Deputy Attorney General
1515 K Street, Suite 511
P.O. Box 944255
Sacramento, California 94244-2550
Telephone: (916) 324-5154

Attorneys for Defendant

SUPERIOR COURT OF THE STATE OF CALIFORNIA

FOR THE COUNTY OF SACRAMENTO

SHISEIDO COSMETICS (AMERICA) LTD.	) NO. 336238
Plaintiff,	) ORDER GRANTING MOTION TO AMEND ANSWER
v.	)
FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA,	) Date: August 8, 1989) Time: 9:30 a.m.
Defendant.	) Dept.: 28

The motion of defendant Franchise Tax Board to amend its answer having been calendared for hearing on August 8, 1989, at 9:30 a.m. before the Honorable Jeffrey L. Gunther, presiding, and no request for oral argument having been

received by the court, the court adopts as its ruling the tentative ruling as follows:

Motion granted. Exhaustion of administrative remedies is jurisdictional. This ruling is without prejudice to estoppel being raised at trial.

DATED:

JUDGE OF THE SUPERIOR COURT

Appendix F

JOHN K. VAN DE KAMP,
Attorney General of the State of California
ROBERT F. TYLER
Supervising Deputy Attorney General
JOHN D. SCHELL, Bar #42573
Deputy Attorney General
1515 K Street, Suite 511
P.O. Box 944255
Sacramento, California 94244-2550
Telephone: (916) 324-5154

Attorneys for Defendant

SUPERIOR COURT OF THE STATE OF CALIFORNIA

FOR THE COUNTY OF SACRAMENTO

SHISEIDO COSMETICS (AMERICA) LTD.	) NO. 512689
Plaintiff,	) ORDER GRANTING DEFENDANT'S MOTION FOR JUDGMENT ON THE PLEADINGS, AND JUDGMENT
v.	
FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA,	
Defendant.	) Date: June 18, 1990) Time: 9:00 a.m.) Dept.: 27) Judge: Ronald B. Robie

ORDER

Upon plaintiff's request for oral argument, defendant's Motion for Judgment on the Pleadings came regularly before

the court on June 18, 1990, the Honorable Ronald B. Robie presiding. Attorneys Lloyd de Vos and Robert R. Rubin appeared for plaintiff and Deputy Attorney General John D. Schell appeared on behalf of defendant. After listening to oral argument and in consideration of the written record, the court affirms its tentative ruling as follows:

> "Motion for judgment on the pleadings. The June 29, 1989 letter denominated a 'Claim for refund' is untimely unless it relates back to the payment by check 'under protest.' Although the complaint at p. 5, ¶ 23 alleges that the June 29, 1989 letter was a '. . . timely filed . . . claim for refund perfecting its prior informal claim for refund . . .' since both the checks and June 29, 1989 letter are part of the complaint, this legal conclusion is not binding on the court. The checks paid 'under protest' cannot be considered a request for refund. Among other things, no reasons are stated. The complaint alleges that defendant's admission in an answer in another lawsuit that all administrative remedies available to plaintiff had been exhausted at that time provides a basis for estoppel so that defendant cannot deny that the checks were a proper request for refund. This does not provide such a basis for estoppel. *Patane v. Kiddoo* (1985) 167 Cal.App.3d 1207, 1214. The tolling argument that the admission led plaintiff to believe that they had fully complied is just another way of stating the estoppel argument. Nor was there tolling to perfect the claim since tolling the time to perfect the claim requires that the original claim be sufficient, which it was not. *Bollinger v. National Fire Insurance Co.* (1944) 25 Cal.2d 399 is not applicable. It has been limited to its facts.
>
> "Granted without leave to amend."

DATED: June 27, 1990

RONALD B. ROBIE

JUDGE OF THE SUPERIOR COURT

JUDGMENT

Defendant's Motion for Judgment on the Pleading having been granted without leave to amend, the court grants judgment for defendant and against plaintiff. The complaint is ordered dismissed and defendant shall recover costs in the amount of $ _____.

DATED: June 27, 1990

RONALD B. ROBIE
JUDGE OF THE SUPERIOR COURT

ATTEST:
JOYCE E. RUSSELL, CLERK [SEAL]
BY P. ALLEN
DEPUTY CLERK

Appendix G

[LETTERHEAD OF STATE BOARD
OF EQUALIZATION]

JUNE 25, 1985

De Vos & Co.
One World Trade Center
Suite 2857
New York, NY 10048

Lloyd De Vos

Gentlemen:

Appeal of Shiseido Cosmetics (America) Ltd.
79A-449

Income Years Ended	Proposed Assessments by Franchise Tax Board
11-30-71	$10,386.36
11-30-72	11,694.66
11-30-73	12,297.91
11-30-74	9,645.64
11-30-75	9,310.00

The Board of Equalization decided the above appeal pursuant to section 25667 of the Revenue and Taxation Code on June 25, 1985, by ordering that the action of the Franchise Tax Board on the protest against proposed assessments of franchise tax for the above years be sustained.

Appellant's decision not to contest the issues of whether appellant's business constituted a unitary business with that of its corporate parent, Shiseido Co., Ltd. of Tokyo, Japan, and whether the amounts allocated and apportioned to California represent a proper allocation and apportionment of the tax base of the business to California for the years at issue, left only a constitutional issue before the Board. The Board determined that section 3.5 of Article III of the Cali-

fornia Constitution precludes it from deciding the constitutional issue.

ATTEST: /s/ DOUGLAS D. BELL
Executive Secretary

cc: Shiseido Cosmetics (America) Ltd.

Appendix H

[LETTERHEAD OF FRANCHISE TAX BOARD]

In reply refer to:
410:RAW:pc
SHISEIDO COSMETICS

October 24, 1979

Hill, Betts & Nash
One World Trade Center, Suite 5215
New York, NY 10048

Attention: Lloyd De Vos

Protest of Shiseido Cosmetics—
America—Ltd.
Income Years Ended November 30, 1971
through November 30, 1975

Gentlemen:

Thank you for your letter of October 3, 1979.

The tests for determining whether or not a business is unitary were well stated in the *Appeal of F. W. Woolworth Co.*, Cal. St. Bd. of Equal., July 31, 1972, CCH 204-806, P-H 13,406-L:

> The California Supreme Court has set forth two general tests for determining whether a business is unitary. In *Butler Bros.* v. *McColgan*, supra, it held that the existence of a unitary business is definitely established by the presence of: (1) unity of ownership; (2) unity of operation, as evidenced by central purchasing, advertising, accounting and management division; and (3) unity of use in its centralized executive force and general systems of operation. Subsequently, in *Edison California Stores, Inc.* v. *McColgan*, 30 Cal. 2d 472 [183 P.2d 16], the court stated that a business is unitary when the operation of the business within California contributes to or is dependent upon the operation of the business outside

the state. In later cases these general tests have been reaffirmed and have been given broad application. (*Superior Oil Co.* v. *Franchise Tax Board*, 60 Cal.2d 406 34 Cal. Rptr. 545, 386 P.2d 33]; *Honolulu Oil Corp.* v. *Franchise Tax Board*, 60 Cal. 2d 417 34 Cal. Rptr. 552, 386 P.2d 40]; *RKO Teleradio Pictures, Inc.* v. *Franchise Tax Board*, 246 Cal. App. 2d 812 [55 Cal. Rptr. 299].) The California courts have yet to clearly delimit the unitary business concept, except to state, "It is only if [a foreign corporation's] business within this state is truly separate and distinct from its business without this state, so that the segregation of income may be made clearly and accurately, that the separate accounting method may properly be used." (*Butler Bros.* v. *McColgan*, supra, 17 Cal. 2d 664, 667-668.)

1. *Intercompany Sales.*

Perhaps the single most important factor in establishing unity is the presence of substantial intercompany sales. The theory underlying intercompany sales originally was that such sales were of goods purchased at a volume discount which resulted in savings to the subsidiary. However, most subsidiaries normally purchase products from affiliates at market or comparable prices. At first glance it appears as though this will not result in any economies to the group. But that is not so.

First, central purchasing of raw materials by the parent, which then uses them in manufacturing the finished product, which in turn are sold to its subsidiaries or affiliates, will result in lower purchase costs for the components of the finished goods.

Secondly, as early as the *Appeal of Youngstown Steel Products of Calif.*, Cal. St. Bd. of Equal., May 29, 1952, CCH 200-159, P-H 13,111, the Board of Equalization stated that it is not so much the savings but the fact that there is created a market for and an availability for goods produced by the affiliate that is important. With a more or less guaranteed market, the manufacturing company could very conceivably

purchase its raw materials in greater quantities at discounts and benefit from the other concomitant economies of a large scale production. In the *Appeal of Campbell Chain Company of California*, Cal. St. Bd. of Equal., October 27, 1964, CCH 202-571, P-H 13,346, the Board of Equalization stressed the fact that the subsidiary had supplied the parent with a California market which resulted in a lower per unit cost of production for the out-of-state parent. Obviously, the result will be that the ultimate cost to the group will be considerably lower. The Board of Equalization stated this in the early *Appeal of Gibson Wine*, Cal. St. Bd. of Equal., June 22, 1956, CCH 200-549, P-H 13,153, and repeated it in many later cases such as *Appeal of Amp, Incorporated*, Cal. St. Bd. of Equal., January 6, 1969, CCH 204-013, P-H 13,402-K, and *Appeal of Simonds Saw and Steel Company, et al.*, Cal. St. Bd. of Equal., December 12, 1967, CCH 203-785, P-H 13,401-P.

An examination of the various cases decided over the years discloses that as long as there is substantial intercompany sales, very little else is needed for unity. This is exemplified by decisions such as the following:

1. *Appeal of Combustion Engineering, Inc.*, Cal. St. Bd. of Equal., July 7, 1967, CCH 203-695, P-H 13,401-K. The Board of Equalization stated that intercompany sales plus the interlocking board of directors resulted in unity.

2. *Appeal of White Motor Corporation*, Cal. St. Bd. of Equal., November 15, 1966, CCH 203-536, P-H 13,400-K. The Board of Equalization emphasized that 70 percent of the subsidiary's purchases were made from the parent. To bolster the decision, the Board of Equalization also pointed out the presence of four or five minor unitary factors.

3. *Appeal of Hunt Food and Industries, Inc.*, Cal. St. Bd. of Equal., April 4, 1965, CCH 202-856, P-H 13,364. Fifty percent of the subsidiary's profits came from its sale of the parent's goods. In addition, the Board emphasized the presence of a strong central management evidenced by the centralized board of directors.

4. *Appeal of Cutter Laboratories*, Cal. St. Bd. of Equal., November 17, 1964, CCH 202-695, P-H 13,350. The subsidiary provided the parent with an outlet for almost all of one of the parent's products, these constituting a large part of the subsidiary's purchases and sales. In addition, another subsidiary sold some finished goods to the parent.

5. *Appeal of Campbell Chain Company of California, supra*. The subsidiary was dependent upon the inventories and equipment received from the parent, although the amount of the subsidiary's sales from the parent declined from 76 percent in the first year to 14 percent in the second year. However, there were several other minor unitary factors plus the fact that the parent had supplied the subsidiary with experienced salesmen, supervisors, and access to advice from the officers of the parent.

6. *Appeal of The Weatherhead Company*, Cal. St. Bd. of Equal., April 24, 1967, CCH 203-644, P-H 13,400-Z. The subsidiary's purchases from the parent varied from 4.8 percent to 37.5 percent of its total purchases; the subsidiary also leased cylinders from the parent wherein the rental payments to the parent ranged from 4.9 percent to 35 percent of the total cylinder rentals paid over the years by the subsidiary.

In this case, the taxpayer purchased about 70% of its product from its Japanese parent. As you can see from the above cited cases, unity can be established with a much smaller percentage of intercompany sales.

2. *Use of a Common Respected Name.*

An item of increasing importance as a unitary factor is the use of a common respected name. *Appeal of F. W. Woolworth*, Cal. St. Bd of Equal., July 31, 1972, CCH 204-806. Both the parent and the subsidiary used the eminent name Shiseido. The Shiseido logo was used on many products.

For further enhancing the Shiseido name in this country the Japanese parent paid its American subsidiary $2.4 million and $2.1 million in 1973 and 1974 respectively.

3. *Information and Know-How Transfer.*

The importance of the transfer of know-how as a unitary factor is mentioned in case after case. *Appeal of Anchor-Hocking Glass Corp.*, Cal. St. Bd. of August 7, 1967, CCH 203-728, P-H 13,401-G. *Appeal of Simonds Saw and Steel Company, et al.*, Cal. St. Bd. Equal., December 12, 1967, CCH 203-785, P-H 13,401-P.

Where the businesses are similar and there are interlocking officers and directors, the exchange of know-how is presumed. In this case no such presumption is necessary. During the period in question the parent corporation sent Mr. Toba, a director of a Japanese subsidiary, to the U.S. to serve as the taxpayer's president. During this period the Senior Vice-President and the Treasurer were also transfers from the parent corporation. Finally, there were present here at any given time from one to four product planners from Japan. These people would scrutinize the market, design products, collect statistics. All of these people applied here the know-how acquired from employment at the parent corporation and/or its subsidiaries. Top officers of the parent also visited the American subsidiary every year.

4. *Intercompany Finance.*

Intercompany financing has always been an important indicator of unity. During the years in issue, the parent corporation contributed an additional $1.5 million to the taxpayer's capital. Although the taxpayer obtained its own financing from the Bank of Tokyo Trust Company, it was agreed that the Bank of Tokyo would look to the Japanese parent if the U.S. subsidiary defaulted.

Given the presence of the above unitary indicators, I cannot say that the taxpayer's business was "truly separate and distinct" from that of its Japanese parent. Consequently, I can only conclude that the taxpayer was involved with its parent and its parent's subsidiaries in a single unitary business.

To give you a chance to reply, I will defer taking formal action for 30 days.

As you noted in your protest, some companies are raising constitutional arguments against similar determinations. If you wish, you could pay the tax and file a protective claim for refund or litigate these issues yourself.

Please direct your reply to the undersigned.

Very truly yours,

/s/ RICHARD A. WATSON
Richard A. Watson
Counsel